Department of Finance Canada
Ministère des Finances Canada

Canada at the European Bank for Reconstruction and Development

2009

Report on Operations Under the European Bank for Reconstruction and Development Agreement Act

Canada

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Cette publication est également disponible en français.

Cat. No.: F1-29/2009E-PDF
ISBN 978-1-100-15358-2

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Foreword by the Minister of Finance

I am pleased to present the Department of Finance's 2009 *Report on Operations Under the European Bank for Reconstruction and Development Agreement Act*. The report reflects Canada's strong commitment to transparent, accountable, effective and efficient international financial institutions. These principles, and the valuable role of institutions like the European Bank for Reconstruction and Development (EBRD), have never been more important than during the recent period of global economic and financial instability, which has been particularly challenging for emerging economies in Eastern Europe.

In producing this report, our government is providing members of Parliament and all Canadians with a comprehensive account of Canada's role at the EBRD and our country's objectives:

- Promoting good governance and accountability.
- Ensuring institutional effectiveness.
- Encouraging environmental sustainability and gender equality.

As this report makes clear, considerable progress has been made over the past year, and a number of short- and medium-term actions are planned going forward to help ensure these priorities are met.

However, many challenges remain for the Bank in the aftermath of unprecedented global turmoil. The region was severely hit by the global economic and financial crisis, and the impact has been widespread. Accordingly, this publication provides a report on the effects of the crisis on the EBRD's countries of operations and the Bank's response. It also discusses key issues related to the Bank's fourth Capital Resources Review.

The EBRD has been essential to the region's response to the global economic and financial crisis, and it will continue to play a key role in the region long after the crisis has receded. The EBRD can continue to count on Canada's support for its mission in an ever-changing world.

The Honourable James M. Flaherty, P.C., M.P.
Minister of Finance

Mandate and Role of the EBRD

Overview

The European Bank for Reconstruction and Development (referred to in this document as the EBRD or the Bank) began its operations in 1991. Its aims are to foster the transition towards open, market-oriented economies in Central and South Eastern Europe, as well as in the successor states of the former Soviet Union, and to promote private and entrepreneurial initiative in those countries that are committed to the fundamental principles of multi-party democracy, pluralism and market economics.[1] Where countries are not committed to these principles, the Bank engages only with the private sector. To deliver on its mandate, the Bank focuses its activities on assisting its 29 countries of operations in implementing economic reforms, taking into account the particular needs of countries at different stages in the transition process.

The Bank's overriding focus is the private sector, with a strong operational emphasis on enterprise restructuring, including the strengthening of financial institutions, and the development of the infrastructure needed to support the private sector. The EBRD's charter stipulates that not less than 60 per cent of its financing commitments should be directed either to private sector enterprises or to state-owned enterprises implementing a program to achieve private ownership and control. All of its financing projects have to demonstrate environmental sustainability, as per the Bank's Articles of Agreement. The Environmental Policy is reviewed every three years to help ensure the Bank adopts state-of-the-art best practices in all projects. In May 2008, the Bank adopted a new Environmental and Social Policy, which is of the highest standard of international financial institutions, especially in the area of gender equality.

In promoting economic transition, the Bank acts as a catalyst for increased flows of financing to the private sector, as the capital requirements of these countries cannot be fully met by official multilateral or bilateral sources of financing, and many foreign private investors remain hesitant to invest in the region, particularly the central Asian republics.

The EBRD offers a full array of financial products and services, including:

- Longer-term loans.
- Equity investments.
- Quasi-equity instruments (subordinated loans, preferred stock, income notes).
- Guarantees and standby financing.
- Risk management (intermediation of currency and interest rate swaps, provision of hedging facilities).

The EBRD's operations to advance the transition to a market economy are guided by four principles: transition impact, additionality, sound banking and environmental sustainability. Financing is provided for projects that expand and improve markets, help to build the institutions that underpin a market economy, and demonstrate and promote market-oriented skills and sound business practices. EBRD financing must also mobilize additional sources of financing and not displace them. Bank projects must be sound from a banking perspective, thus demonstrating to private investors that the region offers attractive returns. Adherence to sound banking principles also ensures the financial viability of the EBRD and hence its attractiveness as a co-investment partner for the private sector. Integrity is another important aspect of the Bank's due diligence in selecting projects.

[1] Article 1, Agreement establishing the European Bank for Reconstruction and Development.

The Bank's medium-term operational priorities are premised on: the central importance of creating and strengthening those institutions that ensure markets work well; the key role that small businesses can play in creating dynamic, competitive and more equitable economies; and the key role the transition process plays in supporting the principles of multi-party democracy and pluralism.

To achieve these priorities the Bank focuses on:

- Promoting transparency and accountability in public sector management.
- Developing sound financial sectors linked to the needs of enterprises and households.
- Providing leadership for the development of micro-lending and small and medium-sized enterprises.
- Developing market-based and commercially oriented infrastructure.
- Demonstrating, through selected examples, effective approaches to restructuring viable large enterprises.
- Taking an active approach in its equity investments to improve corporate governance.
- Engaging governments in policy dialogue to strengthen institutions and improve the investment climate.
- Taking a regional approach where appropriate.
- Promoting sustainable development and environmental due diligence.

Countries of Operations

The EBRD has 63 shareholders: 61 countries, the European Community and the European Investment Bank. There were 29 countries of operations in 2009.

Where the EBRD Operates

As of November 2009

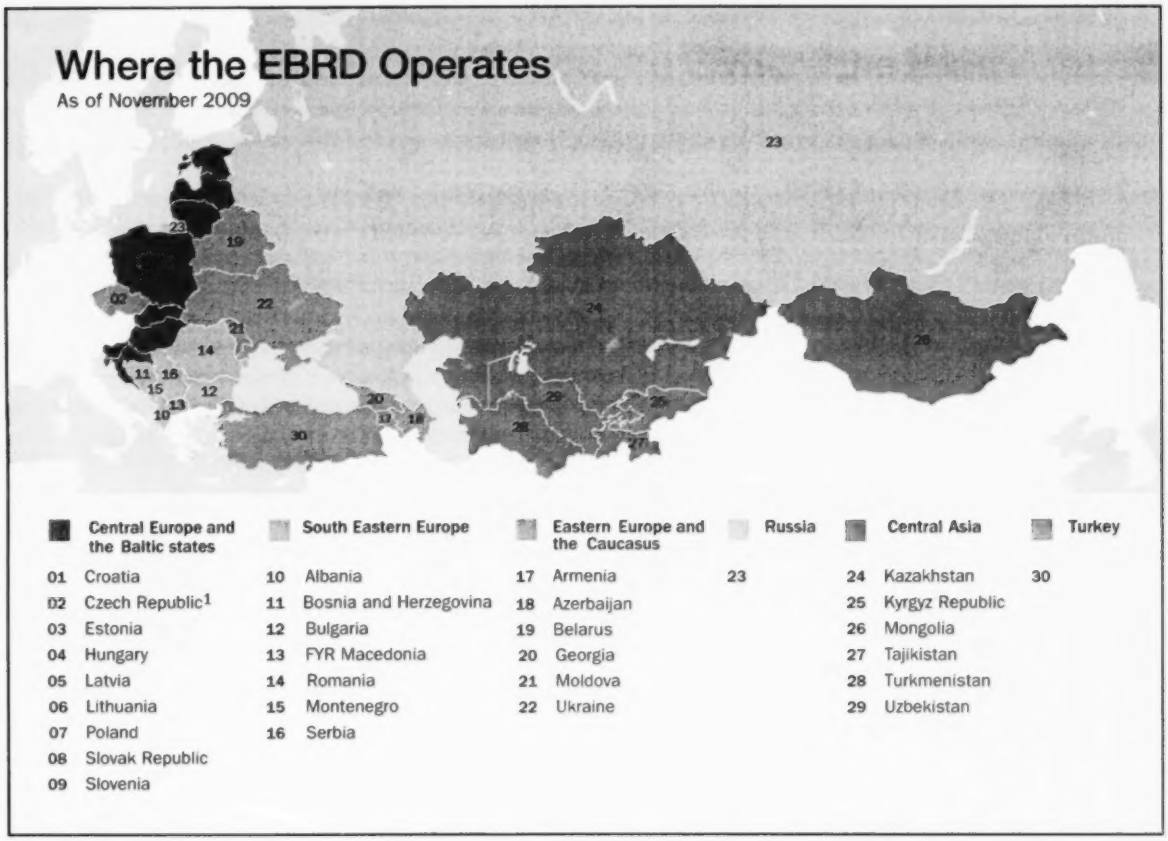
Central Europe and the Baltic states		South Eastern Europe		Eastern Europe and the Caucasus		Russia		Central Asia		Turkey
01	Croatia	10	Albania	17	Armenia	23		24	Kazakhstan	30
02	Czech Republic[1]	11	Bosnia and Herzegovina	18	Azerbaijan			25	Kyrgyz Republic	
03	Estonia	12	Bulgaria	19	Belarus			26	Mongolia	
04	Hungary	13	FYR Macedonia	20	Georgia			27	Tajikistan	
05	Latvia	14	Romania	21	Moldova			28	Turkmenistan	
06	Lithuania	15	Montenegro	22	Ukraine			29	Uzbekistan	
07	Poland	16	Serbia							
08	Slovak Republic									
09	Slovenia									

[1] As of the end of 2009, the EBRD no longer makes investments in the Czech Republic.

Source: EBRD

Countries of Operations

The EBRD has 63 shareholders: 61 countries, the European Community and the European Investment Bank. There were 29 countries of operations in 2009.



[1] As of the end of 2009, the EBRD no longer makes investments in the Czech Republic.

Source: EBRD.

Canada and the EBRD

Benefits of Membership

Canada's membership in the EBRD, and its active participation in the discussion of policy and operational issues, is an important means to help shape regional standards and regulations in the EBRD's 29 countries of operations. By supporting continued political and economic reform, Canada is contributing to the countries of operations' stability and integration into the world economy.

Canada shares with the Bank the overriding objective of developing a strong private sector in its countries of operations, by mobilizing financing for projects with a high transition impact and by providing advice and technical assistance to businesses and governments. Through its participation on the EBRD's Board of Directors and Board of Governors, Canada has been able to press for greater attention to governance issues in the Bank's operations. Moreover, Canada has been able to help shape the environmental and social safeguards that govern the EBRD's lending. The Bank also provides Canada with a vehicle to reach transition countries that are not normally part of our bilateral development assistance programs. For example, bilateral assistance to countries such as Albania, Azerbaijan, Bulgaria, Moldova and the Kyrgyz Republic was less than $100,000, so in these cases the EBRD provides Canada with a way of impacting development/transition goals.

Canada is also interested in raising awareness among Canadian companies of opportunities presented by the EBRD. Canadian companies can seek financing for projects undertaken in the Bank's countries of operations. In addition, to implement transition projects, the Bank often relies on the procurement of goods and services from the private sector in its shareholder countries. This allows Canadian firms to have access to different markets and enjoy commercial opportunities they may not have otherwise had. For example, consulting services is an area where Canada has a comparative advantage and where Canadians have been successful in winning EBRD-financed contracts. Canadian consultants were awarded 52 contracts in 2009 valued at €2,293,097, an increase of €113,510 over 2008.

Role of Canadian Government Departments

The responsibility for oversight of the EBRD's key activities resides with the Department of Finance. The Department of Finance coordinates Canadian policy advice and manages Canada's strategic interests at the EBRD in consultation with Foreign Affairs and International Trade Canada and the Canadian International Development Agency (CIDA).

Canada's Representation at the EBRD—The Honourable James M. Flaherty, Minister of Finance, is the Canadian Governor and Mr. Leonard J. Edwards, Deputy Minister of Foreign Affairs, is the Alternate Governor. Canada's resident representative on the EBRD Board of Directors is Ms. Suzanne Hurtubise. The constituency also includes Morocco. Ms. Judith St. George is the non-resident Alternate Director and represents Canada in the absence of the Canadian Director.

Canadian Staff at the EBRD—Canadians are well represented on EBRD staff. At the end of 2009, there were 32 Canadian professionals on the staff of the EBRD, representing 3.3 per cent of total professional positions, just under Canada's 3.4 per cent share of the institution's capital. Canadians fill the following senior positions: Deputy Chief Compliance Officer; Director for Czech Republic, Hungary, Slovak Republic and Slovenia; and Director of the Early Transition Countries Initiative.

Canada's Contribution to Ordinary Capital Resources

At the end of 2009, the Bank's total authorized capital was €20 billion. Canada is the eighth largest shareholder, contributing 3.4 per cent, representing €680 million of the Bank's capital. Canada's contribution is 25 per cent paid-in capital (€170 million). The remainder is callable capital, which is a contingent liability and would only be provided in the unlikely event that the institution would face severe financial difficulty. Callable capital serves as a guarantee from shareholders for bonds issued by the EBRD in world financial markets.

Canada's paid-in capital is provided in a series of instalments of cash and non-interest-bearing demand notes that are then encashed over a five-year period. Payments are made in eight equal annual instalments (40 per cent in cash and 60 per cent in non-interest-bearing demand notes encashed over five years). Canada made its last payment of its current capital subscription to the EBRD in June 2009.

Table 1

Canadian Payments to the EBRD

Year	Total cash payments in US$ (includes note encashment and cash payments)	Total cash payments in C$[1] (includes note encashment and cash payments)
1991	23,807,004	27,278,065
1992	15,871,336	19,177,335
1993	19,839,170	25,588,561
1994	23,807,004	32,517,987
1995	23,807,004	32,677,494
1996	7,935,668	10,821,077
1997	3,967,334	5,492,325
1998	6,315,572	9,366,645
1999	7,773,010	11,549,451
2000	9,230,449	13,709,085
2001	10,687,891	16,549,305
2002	12,145,331	19,072,539
2003	12,145,331	17,021,217
2004	12,145,331	15,807,394
2005	12,145,331	14,715,677
2006	5,829,759	6,611,492
2007	4,372,320	4,699,291
2008	2,914,880	3,107,304
2009	1,457,440	1,637,871

[1] Exchange rates are based on Bank of Canada annual noon exchange rate averages.

Canada's Contribution to Special Funds

As part of a loan or equity investment, the EBRD often supports its clients with advice on project preparation and effective implementation. This advice is often paid for out of special funds, which are set up by donor countries and international institutions and are managed by the Bank. These funds mobilize investment capital and expertise in the EBRD's countries of operations by giving local business access to consultant experts. The consultants assist in the preparation of projects and strengthen local management know-how. They also develop environmental strategies and work to improve the legal framework in which businesses operate. Canada has contributed to the following special funds:

Early Transition Countries Multi-Donor Fund—CIDA is one of 12 donors to this fund, which was launched in 2004 and targets Bank programming in the poorest countries of the EBRD's operations (Mongolia, Moldova, Azerbaijan, Armenia, Georgia, Tajikistan, the Kyrgyz Republic and Uzbekistan). This fund is the first EBRD funding mechanism to be classified as Official Development Assistance by the Development Assistance Committee of the Organisation for Economic Co-operation and Development. Since 2004, Canada has contributed C$1.7 million to this untied fund.

Western Balkans Multi-Donor Fund—This fund, which was established in 2006, is active in Albania, Bosnia and Herzegovina, FYR Macedonia, Montenegro, and Serbia (including Kosovo). It focuses on technical support to prepare and implement investments that are important for economic growth, regional cooperation and integration with the European Union (EU). Priority areas are energy, transport, the environment, private sector development and institution building. At present the fund has 15 donor countries. It has been extremely useful for mobilizing and leveraging CIDA funds with those of other donors to increase donor impact in the region. In 2009 the Western Balkans Multi-Donor Fund merged with EU and European Investment Bank funds to create the Western Balkans Infrastructure Fund to enable better coordination among donors.

Canadian Technical Cooperation Fund—The main purpose of this fund is to provide financing to hire consultants for EBRD projects across a wide range of sectors and EBRD countries of operations. Canada has transferred C$21 million to the EBRD for technical cooperation since 1992. Canada's contribution was renewed in 2006. The fund allows for technical cooperation in Armenia, Georgia, Russia and Ukraine. The sectors of focus include the environment, private sector development and municipal governance.

Chernobyl Shelter Fund (CSF)—The main purpose of this fund, which was launched in 1995, is to secure the sarcophagus around the destroyed Unit IV nuclear reactor in Ukraine. The CSF finances the implementation of the Shelter Implementation Plan, which includes the construction of a permanent confinement facility, enhanced radiation monitoring, and general improvements to nuclear and worker safety. The CSF has experienced cost overruns and the total estimated cost of this project is not expected to be finalized before mid-2010. The Canadian contribution to date has been almost €35 million of a total of €854.6 million in donor contributions. Current resources are expected to cover work until 2011.

Nuclear Safety Account (NSA)—This facility was established in 1993 to help address nuclear safety issues in Central and Eastern Europe. Specifically, the NSA finances the decommissioning of old Soviet-style reactors including those at Chernobyl, where donors are funding the construction of an interim spent nuclear fuel storage facility and a liquid radwaste treatment facility. Canada has contributed almost €15.4 million to the total donor contribution fund of €319.9 million. Like the CSF, the NSA has experienced cost overruns and final design phase costs are not expected to be finalized before mid-2010.

CIDA-EBRD Cooperation Fund for South Eastern Europe (CFSEE)—By 2002, Canada had contributed C$10 million in support of the EBRD's South Eastern Europe Action Plan, to be used for technical cooperation and co-financing activities. These funds were used in Albania, Bosnia and Herzegovina, Bulgaria, Croatia, FYR Macedonia, Romania, Serbia, and Montenegro, and supported activity by Canadian consultants. In 2003, an additional C$6 million was added to the CFSEE, which focuses on CIDA priority sectors and countries of focus. In 2006, CIDA transferred the remaining CFSEE funds to the Western Balkans Initiative, which includes within its scope a multi-donor technical cooperation fund and is intended to improve donor coordination arrangements in the Western Balkans.

TurnAround Management Programme—The TurnAround Management Programme was established in 1993 to match senior industrial advisors from market-driven economies with chief executives of selected firms in the region that are in financial difficulty. The objective is to provide management know-how and develop business skills so that these companies can become competitive and profitable. Canada has contributed C$3 million to this fund.

Northern Dimension Environmental Partnership (NDEP)—The NDEP was created in 2001 to fund the safe and secure management of the spent nuclear reactor fuel and other radioactive wastes generated by the dismantling of Russia's Northern submarine fleet. The NDEP's focus on infrastructure is critically important as it fundamentally helps improve the dismantlement process by securing spent nuclear fuel and radioactive material at various sites and increasing storage capacity. By the end of 2006, the NDEP had secured investments of more than US$1.5 billion for environmental projects. In 2003–04, Canada joined over 10 other donors by contributing C$32 million to the NDEP. Canada's Global Partnership Program is responsible for monitoring the NDEP. While progress has been satisfactory, Canada is not considering an additional contribution.

Canada at the EBRD: What Happened in 2009

Impact of the Economic and Financial Crisis on the EBRD's Countries of Operations

Between the fourth quarter of 2008 and the second quarter of 2009, the EBRD region underwent the steepest economic contraction since the early years of transition. As of January 2010, the EBRD estimates that real gross domestic product (GDP) declined by just over 6 per cent in 2009, with significant variances across countries ranging from double-digit contractions in the Baltic countries, Ukraine and Armenia to no contractions in Poland, Albania and much of Central Asia.

While the region as a whole has been affected by the crisis, the situation differs from country to country largely depending on their pre-crisis foreign currency reserve position, their exchange rate regime, the size of their external debt (private and public), the size of the pre-crisis credit boom, and their level of integration with the European Union (EU).

EU members with fixed exchange rates, including Bulgaria, Estonia, Latvia and Lithuania, have been particularly hard hit by the crisis. Due to the large internal and external imbalances caused by significant amounts of foreign-currency-denominated loans, booming credit growth and skyrocketing inflation, these countries were not prepared to adjust economically when external capital flows and export demand dried up.

In order to meet the accession criteria[2] outlined by the EU, all adjustment that has taken place to date has been pursued through the real economy to maintain small budget deficits and to defend fixed exchange rates. As a consequence, these countries (with the exception of Bulgaria, due to a strong fiscal reserve position) experienced dramatic economic contractions in excess of 10 per cent in 2009.

Although the imbalances in EU members with flexible exchange rates, including Hungary, Poland and Romania, are not as significant as the previous group of countries, they have also been hard hit by the drying up of external capital flows and export demand. While constrained by the same EU accession criteria, this group was able to absorb some of the economic adjustment via a flexible exchange rate, which allowed trade balances to improve and current account deficits to decline. However, the significant amount of foreign currency lending poses an even greater concern for these countries as depreciating exchange rates make it more difficult for residents to repay loans denominated in foreign currency. This led to a continued pronounced decline in lending and a significant spike in non-performing loans in 2009.

Countries in Southern and Eastern Europe that have significant exposure to Western European banks have been affected by the deleveraging of their subsidiaries. Serbia, for instance, has been particularly prone to this, forcing the country to first take a precautionary loan from the International Monetary Fund (IMF), which was followed by a larger loan, primarily in response to the need to recapitalize its financial sector. Bosnia has also participated in an IMF lending program.

[2] In order to accede to the Economic and Monetary Union (EMU) of the European Union, several convergence criteria must be met, outlined in Article 109j(1) of the Maastricht Treaty. These include: *1) CPI Inflation Rate Criterion, 2) Nominal Interest Rate Criterion,* and *3) Nominal Exchange Rate Stability Criterion*. Further, in order to accede to the EMU and maintain membership, the Excessive Deficit Procedure must be adhered to, which contains two additional criteria: *Budget Deficit Criterion* and *Public Debt Criterion*.

Turkey, while having significantly less exposure to Western European banks, still maintains the EU as its primary export market. Sharply declining exports, combined with uncertainty surrounding the government's ability to fund the sizable external financing gap this year, has led to a significant decline in investment and output, causing higher levels of unemployment.

Central Asian countries, including the Kyrgyz Republic, Mongolia, Tajikistan, Turkmenistan and Uzbekistan, have been hard hit by the sharp decline in commodity prices brought on by declining global demand as well as decreases in remittances from workers abroad.

Russia has also been hard hit by the decline in energy prices, seeing its large oil current account surplus decline, forcing the economy as a whole to become a net importer. The ruble has consequently depreciated about 30 per cent against the US dollar over the last year.

Finally, sharply declining export demand and capital inflows led to Ukraine receiving an IMF loan in November 2008. Ukraine's economy shrank 15 per cent in 2009, and the IMF projects modest growth of 2.5 per cent in 2010.

Although some of the EBRD's countries of operations have started a gradual recovery, with many experiencing positive growth in the third quarter of 2009, the Bank believes that the gains are fragile and vulnerable to external and domestic shocks. Furthermore, the situation remains difficult in several countries.

There are likely to be large cross-country differences in the pace of recovery. Countries with large export sectors, competitive exchange rates and sound pre-crisis banking systems are best positioned. By contrast, in countries with high non-performing loans and weaker institutional frameworks for debt restructuring, the recovery is likely to remain constrained by slow credit growth resulting from continuing weakness in bank balance sheets.

The EBRD's current medium-term scenario assumes sluggish growth of 3 to 4 per cent for the region as a whole from 2010 to 2012, followed by a gradual return to healthier growth from 2013 to 2015.

While the financial crisis has slowed the pace of reforms in the region, so far it has not led to reform reversals, systematic bank crises or uncontrolled currency collapses.

The EBRD's Response to the Crisis

The EBRD's region of operations was severely hit by the economic and financial crisis. The Bank's response and increased lending was instrumental in helping to mitigate some of these effects on the transition economies.

The Bank responded to the crisis by increasing and redirecting its investments. In 2009, the Bank stepped up its crisis response by increasing its annual business volume to a high of €8 billion, which is an increase of nearly 50 per cent from an average of €5.4 billion in the previous three years. The Bank has also doubled the size of its trade facilitation program, which provided companies with greater access to trade finance. Chart 1 below shows the level of EBRD investments and gross disbursements for 2001 to 2009, and demonstrates the increase in both investments and disbursements in 2009 over past years.

In addition to scaling up its activities, the Bank also refocused its project targets. Due to the nature of the crisis, the initial focus of the response was the financial sector. The objective was to help ensure that systemic institutions remained committed to the region and maintained a continued flow of financing to businesses. The EBRD also provided critical refinancing and support to the corporate and infrastructure sectors, and targeted energy security and energy efficiency needs.

As well, the EBRD stepped up its coordination efforts with other key stakeholders. The Vienna Initiative was created in early 2009 to coordinate the responses of major public and private shareholders to the financial crisis in the European transition countries. It brings together the home and host country authorities of the major EU-based bank groups, the bank groups themselves, the EBRD, the IMF, the World Bank, the European Investment Bank and the European Commission. The Initiative's objectives were to determine respective responsibilities, provide a coordinated response to the crisis and keep international bank groups engaged.

To have additional operating headroom and greater flexibility in its crisis response, the Bank changed the interpretation of its gearing ratio[3] from an adjusted portfolio to an operating assets basis. Further analysis on the required capital resources will be forthcoming as part of the Bank's fourth Capital Resources Review, which will also lay out the Bank's strategic direction for 2011–2015.

[3] The gearing ratio is the ratio of a financial institution's capital to its outstanding loans or its outstanding borrowing. In the case of the Bank, it is the key statutory measure used to reflect its capital adequacy. Its reinterpretation from an adjusted portfolio to an operating assets basis provides for significant additional operational headroom, which will allow the Bank to continue its crisis response.

Chart 1

EBRD Annual Investments and Gross Disbursements

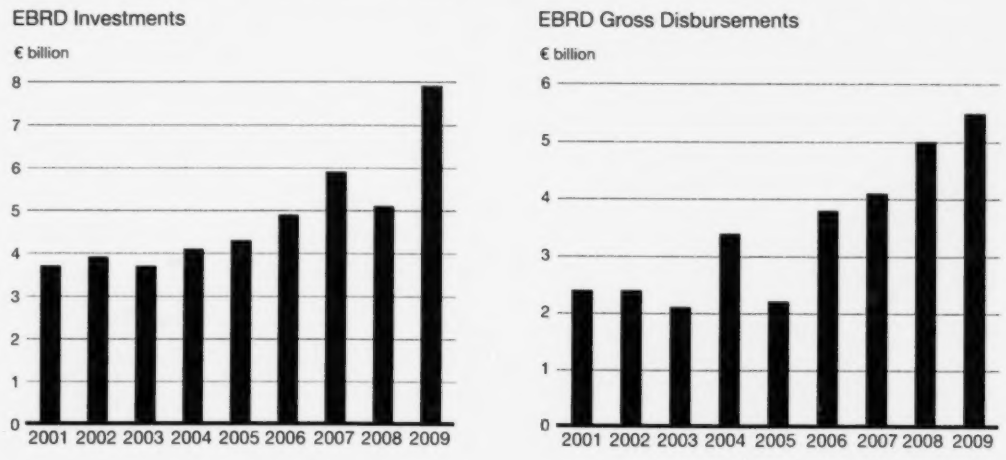


Table 2

The EBRD's Financial Results

	2009	2008	2007	2006	2005
Number of projects	311	302	353	301	276
			(€ million)		
EBRD financing	7,861	5,100	5,583	4,936	4,277
Resources mobilized	10,353	8,390	8,617	8,915	6,211
Total project value	18,087	13,490	14,200	13,851	10,488
Operating income	-209	-981	1,611	2,667	1,543.9
Expenses and depreciation	-246	-250	-251	-225	-218.9
Operating profit before provisions	-455	-1,231	1,353	2,442	1,325.0
Provision for impairment of loans and guarantees	-567	-232	201	-53	200.6
Net profit for the year	-618	-826	1,884	2,389	1,525.6
Reserves and retained earnings	6,317	6,552	8,676	6,974	4,656.1
Provisions for impairment of loans and guarantees (cumulative)	203	227	124	341	351.6
Total reserves and provisions	**6,317**	**6,600**	**8,800**	**7,315**	**5,007.7**

The EBRD's Fourth Capital Resources Review

The Agreement establishing the Bank stipulates that the Board of Governors shall review the capital stock of the Bank at intervals of not more than five years. The preparation of the Fourth Capital Resources Review (CRR4) has been advanced by one year in response to the global crisis.

The Bank launched a strategic review process in November 2008, which was unanimously endorsed by the Board of Governors at the Annual Meeting in May 2009, providing the medium-term strategic foundation for CRR4. The outcome reiterated that the Bank will remain focused on its core competencies:

- Supporting the development of solid and well-governed banks and capital markets through direct investments.
- Supporting smaller businesses, high standards of business conduct, diversification and value-added creation.
- Supporting directly well-regulated energy supply and security, and leveraging energy efficiency across economic sectors.
- Supporting local governments and developing efficient transport systems, involving both the public and private sectors.

The review also highlighted the importance of international financial institution (IFI) collaboration and proposed that IFIs could develop guidelines for cooperation.

The CRR4 exercise is essential as it will lay out the medium-term orientations of the EBRD for 2011–2015 in terms of transition, operational activity, risk, financial performance, resources and capital requirements.

This resources review is being formulated at a time when the portfolio of the Bank has been negatively affected by an external crisis with a rise of impairment and provisions. CRR4 will need to support the return of the EBRD to a positive profit outlook.

The Bank intends to finalize CRR4 in time for the EBRD's annual meeting in May 2010 in Zagreb, Croatia. Canada's position during the ongoing discussions will take into consideration its key standing priorities. The current resources review is an opportune time for Canada to advance its policy priorities at the EBRD.

Canada's Voting Record in 2009

Canada and other shareholders typically raise concerns and ask questions about specific Bank operations before they get to the Board of Directors. As a result, decisions at the Board are generally taken by consensus. Directors may, however, abstain or vote against projects or policies in consultation with their constituencies. The Canadian Director supported all policies in 2009 (with the exception of the Belarus strategy), as well as the vast majority of the 170 projects approved by the Board. There were 4 exceptions, which were based on 2 main reasons:

- **Lack of transition impact.** Helping to move a country closer to a full market economy ("transition impact") is one of the EBRD's core operating principles. As per Article 2 of the Agreement establishing the European Bank for Reconstruction and Development, transition is fostered through various measures including: promoting the establishment, improvement and expansion of productive, competitive and private sector activity and the mobilization of capital and experienced management to this end; fostering productive investment, including in the service and financial sectors, and in related infrastructure where necessary to support private and entrepreneurial initiative; providing technical assistance; and supporting multinational projects and/or projects with more than one donor country. Concerns are raised whenever it is anticipated that an investment will not achieve an incremental transition impact on these terms. The Canadian Director abstained on the Belarus strategy and two projects on these grounds.

  1. The Country Strategy for Belarus: As the Belarusian government has not demonstrated sufficient movement to improve multi-party democracy, pluralism and good governance required to develop a market economy, Canada abstained on the new strategy which would allow the Bank to engage more closely with the government on upcoming projects.
  2. An EBRD loan of up to US$150 million to VTB:24 for on-lending to micro and small enterprises. VTB:24, which is owned by the Government of Russia, is one of the leading banks in Russia. While its regional reach allows for many clients to access finance, the state ownership and therefore the lack of promotion of private enterprise was considered to outweigh the access-to-finance argument.
  3. An EBRD loan of up to €150 million to K10, a daughter company of Public Enterprise Roads of Serbia. The Canadian Director suggested that it would be better for the European Investment Bank to provide this loan as the transition impact would be limited.

- **Integrity concerns.** The Canadian Director abstained on a €200-million loan to MOL Hungarian Oil and Gas Public Limited Company to complete the first strategic gas storage facility in Hungary due to the opacity of the beneficial shareholder.

Canadian Policy Priorities for 2010–2012

To promote greater transparency and accountability, the Government has identified three standing priorities for the EBRD:

1. Promoting good governance and accountability.
2. Ensuring institutional effectiveness.
3. Encouraging environmental sustainability and gender equality.

The following section describes progress that was made in 2009, as well as the planned short- and medium-term actions for 2010–2012.

At the London Summit, G20 Leaders committed to ensuring that multilateral development banks have sufficient resources going forward, and urged them to complete a review of their capital needs by the first half of 2010. Canada's priority for 2010 is to ensure that the EBRD continues to provide an adequate response to its countries of operations and has the necessary resources to respond to the crisis and carry out its mandate post-crisis. A key component of the resources discussion will be to make sure the Bank makes the necessary reforms to ensure it is in position to effectively respond to future adversity and opportunities in a coordinated and comprehensive manner.

Assessment of Progress on the 2009 Priorities and Planned Actions Going Forward

The chart below summarizes actions identified in last year's report that will be carried forward for 2010–2012, as well as new priorities going forward. These priorities and action items are grouped under three broad objectives: (1) Governance and Accountability; (2) Institutional Effectiveness; and (3) Environmental Sustainability and Gender Equality. The chart provides a colour-coded assessment of the EBRD's progress against Canada's existing priorities (not Canada's efforts to achieve the priorities). Reporting on the results achieved in 2009 and remaining challenges are discussed in more detail following the summary chart.

Colour code: Little Progress Some Progress Good Progress

1) Governance and Accountability		
1.1 Greater Transparency		
Timeframe	Action Item	Progress
Medium Term 2010–2012	Encourage the Bank to incorporate a transparent, open and merit-based process for appointing senior management into the EBRD by-laws.	
Medium Term 2010–2012	Encourage the Bank to release the transition impact ratings of its projects as part of its public project summary documents.	**NEW**
1.2 Sustainable Finances		
Short Term 2010	Ensure that good financial governance and effective use of the Bank's capital are at the centre of CRR4. Advocate for setting priorities to ensure that the Bank's resources are used efficiently and effectively.	
Short Term 2010	Advocate for a resolution to the general capital increase request, with a response that is low-cost to shareholders and temporary in nature, while at the same time allowing the EBRD to fulfill its transition mandate with a prudent response to the economic and financial crisis.	**NEW**

2) Institutional Effectiveness		
2.1 Promote Economic and Democratic Reform (Article 1)		
Timeframe	Action Item	Progress
Short Term 2010	Actively participate in Board discussions on country strategies. If the analysis suggests that these countries have been slow in implementing Article 1, continue to support limited scope of Bank activities (i.e. support small EBRD operations with private sector entities that address basic human needs).	
Short Term 2010	Press the Bank to identify effective approaches for supporting transition in countries whose commitment to democratic reforms is waning. For example, the Bank should consider focusing on engagement with companies that can demonstrate to the rest of the industry the benefits of environmental and business best practices.	
2.2 Strong Transition Impact		
Short Term 2010	As part of CRR4, advocate for the analysis of the demand the EBRD faces in light of economic and political developments in the region, and the impact on transition in countries of operations. In this regard, advocate for the establishment of clear post-crisis graduation criteria and timelines.	
Medium Term 2010–2012	As the Bank's lending volumes increase to record levels, encourage the Bank to remain disciplined and selective in the use of its capital, and only support activities that are consistent with its transition mandate.	
2.3 Cooperation With Other International Financial Institutions (IFIs)		
Short Term 2010	Encourage the Bank to develop clear guidelines for co-financing with other IFIs, particularly the International Finance Corporation, the European Investment Bank and the Asian Development Bank.	
Medium Term 2010–2012	Encourage the Bank to untie all donor funds, which will increase the effectiveness of technical cooperation and IFI collaboration, as well as increase commercial opportunities.	
2.4 Promote Strong Local Capital Markets (NEW)		
Medium Term 2010–2012	Support the Bank in developing local currency lending and local capital markets.	**NEW**
3) Environmental Sustainability and Gender Equality		
3.1 Gender Equality		
Timeframe	Action Item	Progress
Short Term 2010	Work with donors and bank staff to ensure the implementation of the Gender Action Plan and provide assistance to develop projects and policies.	
Short Term 2010	Encourage the Bank to examine its internal practices and policies with respect to gender equality.	
3.2 Environment		
Short Term 2010	Monitor the Environment and Sustainability Department on the effective implementation of the Environmental and Social Policy, the creation of good practice notes for clients, and internal training for Bank staff on the implications of the policy.	
Medium Term 2010–2012	Monitor the Bank's implementation of Phase 2 of the Sustainable Energy Initiative to ensure that objectives, including carbon reduction targets, are met.	**NEW**

1. Governance and Accountability

1.1 Greater Transparency

Greater transparency is a key component of good governance. Canada continued to encourage the EBRD as well as other international financial institutions to incorporate a transparent, open and merit-based process for appointing senior management.

In 2009, the Bank filled one senior position by direct appointment (representing less than 8 per cent of total senior appointments) down from 7 in 2008 (representing 28 per cent of the total), showing the Bank's improved willingness to use competitive processes. Canada will continue to press the Bank to adopt the very highest standards of internal governance.

Another component of Canada's strategy to ensure greater transparency at the Bank is to encourage the EBRD to release transition impact ratings of its projects as part of its public project summary documents. The achievement of transition impact through the financing of projects is a fundamental objective of the EBRD. All projects are rated based on transition impact potential and risk. While the transition goals are released to the public, the ratings are not. By making public the incremental transition impact contribution of each project and the likelihood that such a contribution will happen can be an important tool for the Bank to demonstrate its impact and its ability to fulfil its mandate to foster transition in its countries of operations.

Going Forward

Medium-Term Action: Encourage the Bank to release the transition impact ratings of its projects as part of its public project summary documents.

1.2 Sustainable Finances

As part of the Bank's crisis response, Canada successfully advocated for a change in the interpretation of the gearing ratio to make more effective use of the Bank's capital. Given the adverse impact of the crisis on the Bank's existing portfolio and the significant increase in lending in 2009 to a historic level of €8 billion, the Bank changed the interpretation of its gearing ratio from an adjusted portfolio to an operating assets basis. This provided the Bank with additional operating headroom and greater flexibility in its crisis response.

As part of the discussions for CRR4, Canada has pushed for good financial governance and the effective use of the Bank's capital. Through its participation in the EBRD's Board of Directors, Canada has advocated that the Bank set clear priorities to ensure that its limited resources are used efficiently and effectively. The EBRD will need to maintain a strong transition focus and be selective in its programming.

Capital increases can result in real budgetary costs for shareholders. Given that many are in a tight fiscal position, Canada will advocate for a resolution to the Bank's general capital increase request that is low-cost and temporary in nature, while at the same time allowing the EBRD to fulfill its transition mandate with a prudent response to the crisis.

Going Forward

Short-Term Action: Advocate for a resolution to the general capital increase request, with a response that is low-cost to shareholders and temporary in nature, while at the same time allowing the EBRD to fulfill its transition mandate with a prudent response to the economic and financial crisis.

2. Institutional Effectiveness

2.1 Promote Economic and Democratic Reform

A new country strategy for Belarus was approved in 2009. While Belarus implemented some democratic reforms, including the release of prominent political prisoners, as well as some economic reforms, Canada abstained on the strategy as there had not been sufficient progress to improve multi-party democracy, pluralism and good governance required to develop a market economy. As the Bank will engage more with Belarus, Canada stressed the importance of working with other IFIs to develop meaningful privatization targets and to continue working with small and medium-sized enterprises.

This strategy is an example of the Bank's new calibrated strategic approach for the three countries with Article 1 concerns,[4] which sets out criteria that must be satisfied for the Bank to engage with state-owned institutions. Canada strongly advocated for this approach.

2.2 Strong Transition Impact

As was clear in the Bank's 2009 *Transition Report*, it was an exceptionally difficult year in the region. While there was a marked slowdown in reforms relative to previous years, the number of instances of previous reforms being dismantled is well below that of the last big crisis that affected the region in 1998.

By helping to build the right conditions towards open, market-oriented economies, the Bank played an important role leading to the graduation of the Czech Republic from Bank operations in 2007. The EU7[5] countries were also on the path to graduation during the CRR3 period (2006–2010) until the crisis hit, threatening to set back the transition process. While graduation has been delayed, the Bank has maintained that this has not changed its policy on graduation. Canada has been supportive of the EBRD continuing business in the EU7 during the crisis so as not to jeopardize the Bank's previous efforts to foster transition; however, as part of the CRR4 discussions Canada will advocate for the establishment of clear post-crisis graduation criteria and timelines.

As the Bank's lending volumes increase to record levels, Canada will encourage the Bank to remain disciplined and selective in the use of its capital, and only support activities that are consistent with it transition mandate. It will be important for the Bank to remain guided by the principle of additionality, assuring that EBRD financing mobilizes additional sources of financing and does not displace them.

Going Forward

Short-Term Action: Advocate for the establishment of clear post-crisis graduation criteria and timelines for EU7 countries.

[4] Belarus, Uzbekistan and Turkmenistan have not had access to all of the Bank's resources over the past number of years due to the respective governments' unwillingness to engage in democratic and economic reform. Because Article 1 of the Agreement establishing the EBRD states that the Bank can only operate in countries that are committed to and applying the principles of multi-party democracy, pluralism and market economics, these countries have been referred to as countries with Article 1 concerns. The Bank has engaged only with small and medium-sized businesses to a very limited degree and not with the governments.

[5] Estonia, Hungary, Latvia, Lithuania, Poland, the Slovak Republic and Slovenia.

2.3 Cooperation With Other International Financial Institutions (IFIs)

The global crisis has proved to be an opportunity for the IFIs to work together in a coordinated and comprehensive manner. Canada is pleased with the Bank's approach to IFI collaboration during the crisis and would like to see it continue after the crisis. By identifying its core strengths relative to other IFIs, the EBRD can coordinate with other institutions to minimize overlap and make the most efficient use of resources.

A good example is the Vienna Initiative forum created in early 2009 to coordinate the responses of major public and private shareholders to the financial crisis in the transition economies.

Canada will continue to encourage the Bank to develop clear guidelines for co-financing with other IFIs, particularly the International Finance Corporation, the European Investment Bank and the Asian Development Bank (ADB). It will become more important over the medium to long term for the EBRD to engage with the ADB as the two banks have common countries of operations in Central Asia. As well, as part of its Strategy 2020, the ADB will be scaling up private sector development and private sector operations reaching 50 per cent of annual operations by 2020.

A key issue for Canada has been untying donor funds, as it increases the effectiveness of technical cooperation and IFI collaboration and promotes competition among suppliers. Around 35 per cent of the Bank's current technical cooperation funds are tied to some degree. This is administratively costly and does not always lead to optimum procurement outcomes. Canada is pleased that the Bank has been consulting with donors to meet its Paris Club commitment and to follow the example of other multilateral development banks on untying funds.

Going Forward

Short-Term Action: Encourage the Bank to develop clear guidelines for co-financing with other IFIs, particularly the International Finance Corporation, the European Investment Bank and the Asian Development Bank.

2.4 Promote Strong Local Capital Markets (NEW)

Canada will support the Bank in its efforts to develop local currency lending and local capital markets. The EBRD is looking to address foreign exchange vulnerability—a significant issue in many countries of operations. The recent financial crisis has highlighted the risks that countries face servicing loans when they borrow in hard currency but have local currency reserves.

The EBRD is seeking to bring together key stakeholders such as regulators/central bankers, other IFIs and private sector players to discuss this issue and to look at the benefits of local currency lending and capital market developments. While local currency lending minimizes foreign exchange risks, it can leave borrowers open to other risks related to the domestic currency market. Canada will encourage the Bank to work closely with stakeholders to develop proper procedures and guidelines for promoting local capital markets to ensure that domestic market risks are addressed through reform and effective market infrastructure (including the legal and regulatory framework, and payment and settlement systems).

Going Forward

Medium-Term Action: Support the Bank in developing local currency lending and local capital markets.

3. Environmental Sustainability and Gender Equality

Gender Equality

Gender equality is recognized as an important component of the development and transition processes, in particular to better leverage the untapped potential of women in emerging markets. For this reason, Canada has worked closely with the EBRD on this issue through various initiatives. Through consistent policy and project support, Canada has assisted and pushed the Bank to demonstrate its commitment to integrate gender equality in its work with countries of operations.

The 2008 Environmental and Social Policy, which affirms the Bank's commitment with respect to sustainable development, now gives special attention to gender equality. It serves as a basis on which to shape the Bank's gender approach in the coming years. Since 2008, the Bank's Environmental and Social Policy has required that environmental and social issues be integrated into the project cycle starting from the appraisal process.

The EBRD has adopted a Gender Action Plan. In September 2009 a new Senior Gender Advisor was appointed and received budget resources for two additional staff to implement the Bank's Gender Action Plan. The EBRD has also identified the President of the Bank as a gender equality champion, has put in place a gender steering committee that is headed by the country director for Romania, and has launched a gender equality initiative for internal staff.

Having demonstrated success stories in the financial institution sector and spending time evaluating how best to incorporate gender into banking activities, the EBRD has now moved forward with more targeted actions. The gender team will begin specific work with three pilot countries (the Kyrgyz Republic, Georgia and Romania) and two specific sectors (Agribusiness and Municipal Infrastructure).

Looking ahead, 2010 looks promising with €2 million proposed to be allocated from the Shareholders Special Fund for proactive gender activities.

These actions demonstrate the EBRD's commitment to improving gender equality in the region.

Environmental Sustainability

The Sustainable Energy Initiative (SEI) was launched by the EBRD in 2006 to address the challenges of energy efficiency and climate change. The first phase of the initiative was completed in 2008, and the Bank has launched the second phase for 2009–2011, which was approved by the Board of Governors in May 2009. The SEI Phase 2 objectives include:

- EBRD SEI financing target range of €3 billion to €4 billion for a total project value of €9 billion to €15 billion.
- Carbon emission reduction range of 25 million to 35 million tonnes per annum.
- A technical assistance grant funding target of €100 million and investment grant funding target of €250 million.

The Bank invested €1.3 billion in energy efficiency and renewable energy activities across all sectors in 2009 (with a total project value of €5.4 billion), equivalent to around 17 per cent of all EBRD investments for the year and amounting to around €4 billion invested since the SEI was launched in 2006. SEI projects signed in 2009 are expected to achieve total carbon emission reductions of 4 million tonnes per annum once fully implemented.

Table 3
SEI Projects Signed in 2009

Category	2009 (SEI Phase 2)	
	Signed (€ million)	Number of Projects
Industrial Energy Efficiency	317	26
Sustainable Energy Credit Lines	135	9
Cleaner Energy Production	577	11
Renewable Energy	125	5
Municipal Infrastructure Energy Efficiency	163	20
Total	**1,317**	**71**

Also, in January 2009, the EBRD received approval to develop a sustainable energy financing facility in Turkey using US$43.25 million (€35 million) of concessional co-financing from the Clean Technology Fund. This is a collaborative effort with the Government of Turkey, the World Bank and the EBRD.

Finally, the Bank implemented good practice notes for all clients and has developed training modules for staff to understand and properly implement the recently approved Environmental and Social Policy.

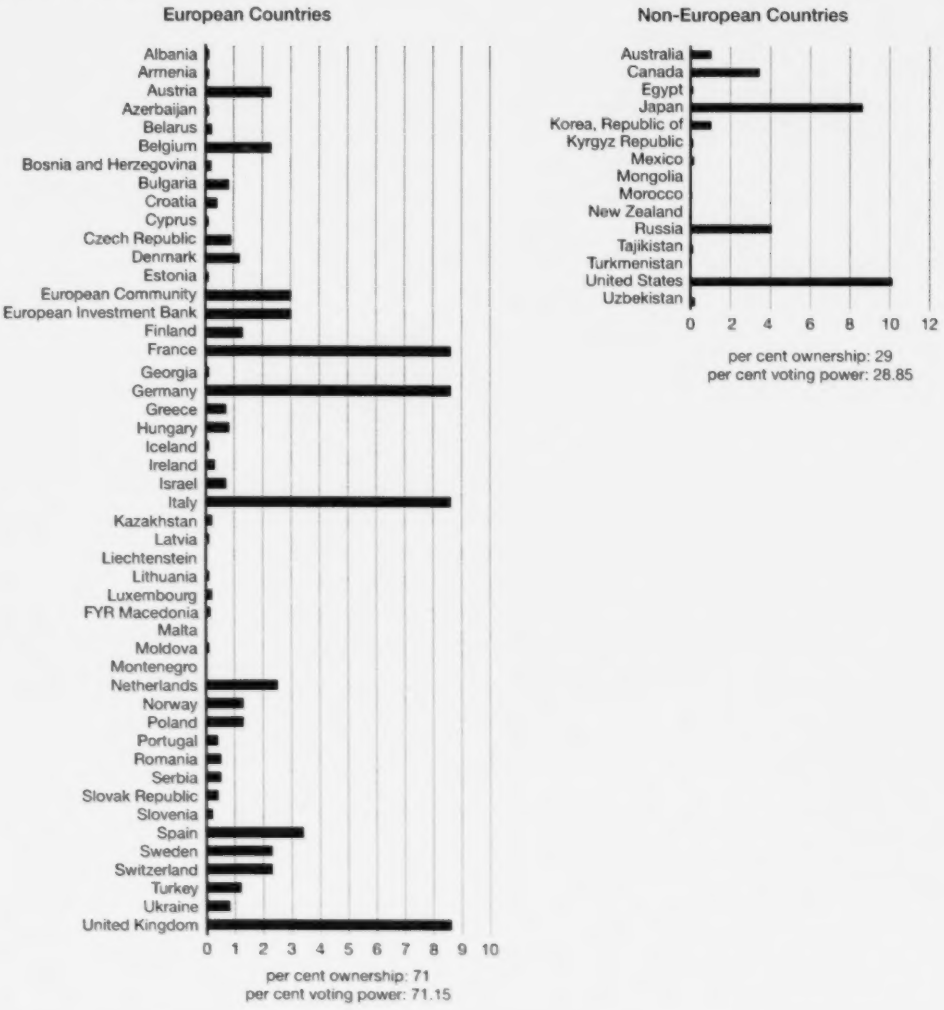
Going Forward

Medium-Term Action: Monitor the Bank's implementation of Phase 2 of the Sustainable Energy Initiative to ensure that objectives, including carbon reduction targets, are met.

Annex 1—EBRD Membership

The EBRD's share capital is provided by member countries, with proportional voting rights. The EBRD's current authorized capital is €20 billion—Canada's capital share is 3.4 per cent.

Chart 2
EBRD Membership



Annex 2—EBRD Governance and Oversight

The highest authority at the Bank is the Board of Governors. It meets annually and approves the institution's annual report, net income allocation and financial statements, the independent auditor's report, the election of the Chair and Vice-Chair for the next annual meeting, as well as other items requiring Governors' approval. A Governor and an Alternate Governor represent each of the 63 shareholders.

The Board of Directors is responsible for the general operations of the Bank. It is composed of 23 members, with each representing either one member country or a constituency of member countries. The Board helps to set the strategic and financial course for the Bank, in consultation with management.

Board Committees

The Board of Directors has established four committees that are responsible for overseeing the activities of the Bank: the Board Steering Group, the Audit Committee, the Budget and Administrative Affairs Committee, and the Financial and Operations Policies Committee. This division of labour is consistent with good corporate governance practices and provides an appropriate system of checks, balances and incentives. In addition, the structure ensures a more effective discussion by the Board, once initiatives are ready for approval.

The Board Steering Group is responsible for the coordination of the committees' work programs to avoid overlap and ensure timely completion. In addition to some administrative duties, the Chair of the Group is the main liaison between the Board and management. The Group is currently chaired by the Austrian Director.

The Audit Committee's primary objective is to ensure that the financial information reported by the Bank is complete, accurate, relevant and timely. The Committee oversees the integrity of the Bank's financial statements and the compliance of its accounting and reporting policies with the requirements set out in the International Financial Reporting System. It also reviews the EBRD's system of internal controls and its implementation, as well as the functions of the internal audit, evaluation and risk management teams. The Committee is currently chaired by the Dutch Director.

The Budget and Administrative Affairs Committee is responsible for ensuring that the Bank's budgetary, staff and administrative resources are aligned with its strategic priorities. To this end, the Committee reviews the medium-term resource framework, annual budgets and the business plan. It also oversees the Bank's human resources policies, including ethics. The Committee is currently chaired by the Czech Director. The Canadian Director is a member of the Committee.

The Financial and Operations Policies Committee oversees the Bank's financial and operational policies, including the annual borrowing plan prepared by the Treasury Department. The Committee also reviews country strategies and proposed projects. It is responsible for the transparency and accountability of the Bank's operations, as laid out in the 2006 Public Information Policy. Since 2007, the Committee has also been charged with overseeing the net income allocation process. As well, it is responsible for the renewal of the Bank's Environmental and Social Policy. The Committee is currently chaired by the French Director.

Annex 3—How the EBRD Works

Project Finance

The EBRD offers a full array of financial products and services, including:

- Longer-term loans.
- Equity investments.
- Quasi-equity instruments (subordinated loans, preferred stock, income notes).
- Guarantees and standby financing.
- Risk management (intermediation of currency and interest rate swaps, provision of hedging facilities).

Eligibility

Eligible projects must be supported by a strong business case, benefit the economy and the transition process of the host country, and comply with the EBRD's environmental guidelines. Projects in all industries are eligible for EBRD financing, except those producing military equipment, tobacco and distilled alcohol. Although it is primarily a financier of private sector projects, the Bank may provide finance to state-owned companies provided they are operating competitively and, in particular, that the financing facilitates or enhances the participation of private and/or foreign capital in such enterprises. The EBRD can finance private companies that are wholly locally owned or foreign owned, as well as joint ventures between foreign and local shareholders.

In order to ensure the participation of investors and lenders from the private sector, the EBRD generally limits the total amount of debt and equity financing for any single project to 30 per cent of total estimated project costs. However, in certain circumstances, and particularly in the current environment, where the syndications market is closed to most of the Bank's clients, the Bank provides a larger share of the project costs. In rare cases, such as when a project is in corporate recovery, the Bank may become the largest shareholder in order to turn the company around and sell it.

EBRD investments range from €5 million to €350 million.[6] Smaller projects are financed both directly by the EBRD and through local financial intermediaries. By supporting local commercial banks, micro-finance organizations, equity funds and leasing facilities, the EBRD has helped finance over 1 million smaller projects.

Fees

The EBRD charges market rates for its private sector financing and provides uniform loan pricing for sovereigns of LIBOR (London Interbank Offered Rate) +100 basis points. In addition, fees vary according to the nature of the project and the amount and complexity of the work required of the EBRD.

Funding of EBRD Activities

The EBRD's equity and quasi-equity investments are funded out of its net worth—the total of paid-in capital and retained earnings. Of the funding required for its lending operations, 100 per cent is borrowed in the international financial markets through public bond issues or private placements.

The EBRD's bond issues have been given AAA ratings by both Moody's Investors Service and Standard & Poor's.

[6] This amounts to C$7.9 million to C$555 million, based on the 2009 average exchange rate.

Policy Dialogue

The Bank uses its close relationship with governments in the region to promote policies that bolster the business environment. The EBRD advises governments on promoting a sound investment climate and stronger institutional framework, which are important for the functioning of the private sector. This dialogue is typically supportive of projects in which the Bank invests. Specifically, the EBRD works with government officials to promote sound corporate governance, anti-corruption practices, fair and predictable taxation policies and transparent accounting standards. In addition, a dedicated legal team advocates for an effective legal and regulatory framework which is not directly tied to a project.

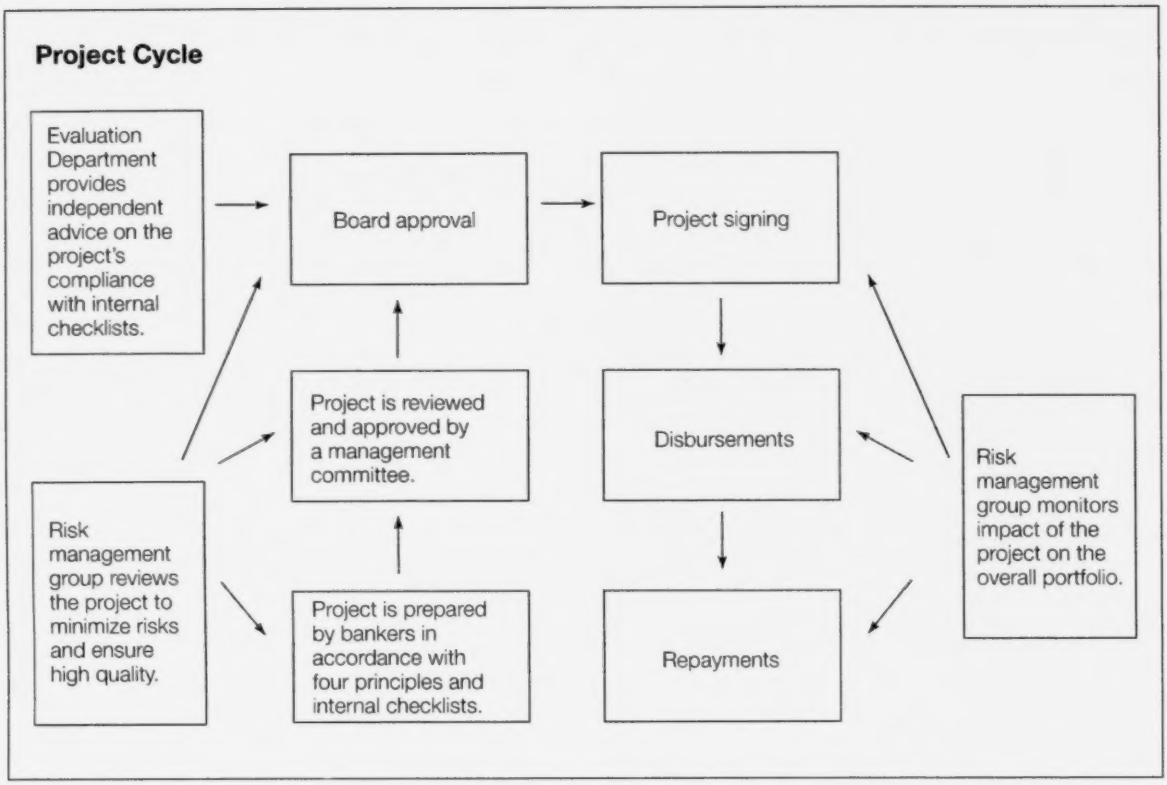
Technical Cooperation

Technical cooperation improves the preparation and implementation of the EBRD's investment projects and provides advisory services to private and public sector clients. It increases the impact of EBRD projects on the transition process by supporting structural and institutional changes, and it assists legal and regulatory reform, institution building, company management and training. Technical cooperation is important to the Bank as it allows thorough preparations for investments, more effective investments in general, and investment opportunities in higher-risk environments in particular.

> Technical cooperation projects are funded by governments and international institutions and managed by the EBRD.

Project Cycle

The EBRD's bankers and their project leaders have the primary responsibility for ensuring a project's compliance with four principles: transition impact, additionality, sound banking and environmental sustainability. However, to ensure that projects continue to generate a significant transition impact, risk management and evaluation groups provide independent advice, lessons learned, and monitoring and review functions throughout the project cycle.


Project Cycle
Evaluation Department provides independent advice on the project's compliance with internal checklists.
Board approval
Project signing
Project is reviewed and approved by a management committee.
Disbursements
Risk management group monitors impact of the project on the overall portfolio.
Risk management group reviews the project to minimize risks and ensure high quality.
Project is prepared by bankers in accordance with four principles and internal checklists.
Repayments

For More Information on the EBRD

The Bank releases considerable information on its various activities. Bank publications include information guides (such as *A Guide to EBRD Financing*), evaluation reports, special reports (such as the annual report and *Transition Report*), country strategies and assorted fact sheets.

Information can also be obtained on the Bank's website at www.ebrd.com.

Requests for information can be addressed to:

Publications Desk
European Bank for Reconstruction and Development
One Exchange Square
London, EC2A 2JN
United Kingdom

Or to: Office of the Director for Canada and Morocco
canadaoffice@ebrd.com

Annex 4—2009 Governor's Speech

Statement by Ted Menzies, Temporary Alternate Governor for Canada, at the EBRD Annual Meeting London, United Kingdom, May 15, 2009

I would like to thank the Government of the United Kingdom and the City of London for kindly hosting the 18th Annual Meeting of the EBRD.

The Bank's countries of operations have gone through dramatic changes since 1989. Canada has taken pride in its participation in the international community's creative response to the fall of communism through the creation of the EBRD, and we continue to do so. Canada believes that engaging with countries that are committed to democratic and economic reform is as important now as it was when the Bank was established.

EBRD's countries of operations are yet again faced with significant challenges. The global financial crisis has ballooned into a global economic crisis which is significantly affecting these countries and their citizens. Supporting them is an international duty that we are pleased to take up through the EBRD.

The past year was a momentous one for the EBRD—a new president, a new country of operations—Turkey—as well as the onset of the financial crisis. After a few years of positive net income, the Bank is facing the consequences of the financial crisis. The Bank's ability to take risk in this context will be a key consideration for the upcoming Capital Resources Review.

The crisis continues to deepen. Gains made over the last decade in promoting prosperity are now at risk. The crisis we are facing today is threatening the speed of the progress made in the transition towards open, market-oriented economies, the very first objective of the Bank.

The swift adoption of the operational response to the crisis by the EBRD's board of directors is starting to have an impact. It allows for a rapid and flexible response and will enable much-needed resources to go to its countries of operations. The Bank's operational response partly rests on an increase in its business volume in 2009 to an historic high of €7 billion in investments. Specific operational initiatives are focused on the financial sector, infrastructure and energy sectors, and on quick-disbursing financing for corporations. We welcome the bank's approach in responding to the crisis, and encourage a review in the fall to determine if further support is warranted.

The Bank's response to the crisis and, we hope, its support for the recovery in an environment of high economic uncertainty, will be important factors in the upcoming discussion on the Bank's capital adequacy during the fourth Capital Resources Review. Canada will actively engage in a discussion that will shape EBRD's medium- and long-term goals and will allow the institution to adapt to its changing environment.

With this context in mind, let us turn to the issues Canada believes should be a focus for the Bank over the next year:

First, the Bank should remain focused on its existing competencies and priorities in the context of the crisis.

Many challenges remain in the Bank's countries of operations and these challenges are further complicated by the financial crisis. Achievements made in financial sectors are already at risk and governments are increasingly pressured to rescue ailing firms and infrastructure projects. With the crisis affecting the real economy and extending to international trade, it may ultimately threaten some of the measures undertaken to open these economies to the rest of the world.

While these challenges make the environment more difficult, the Bank should continue its rigorous application of the three pillars of additionality, sound banking and transition impact for its project-based investments. This approach makes the Bank unique among institutions. The Bank's technical assistance and policy dialogue play important roles. Canada believes that fully untying technical cooperation funds would further improve the Bank's effectiveness. Greater emphasis on gender equality and the role of women in enhancing economic development, as adopted in the new Environment and Social Policy, will also foster greater effectiveness in promoting transition.

Additionally, Canada fully supports the renewal of the Sustainable Energy Initiative, which will further enhance the Bank's effectiveness in promoting transition.

Second, the Bank should ensure its finances are sustainable in this uncertain environment.

Earlier this year, Group of Twenty (G20) members urged the Multilateral Development Banks to step up their counter-cyclical efforts as a means to effectively counter and mitigate the effects of the global crisis. When the Leaders of the G20 met on April 2nd, here in London, they committed to support an increase in MDB lending of at least $100 billion and ensure that the MDBs have appropriate capital.

In line with the G20 commitment, Canada supports the Bank's effort to make efficient use of its capital through the reinterpretation of its gearing ratio. This change provides the Bank with sufficient capital to implement the crisis response it has developed for 2009 and to implement a similar response in 2010 if necessary. However, a comprehensive assessment of the capital base under different business volume and risk scenarios is needed before a capital increase can be considered. We look forward to this analysis over the coming months.

The Bank's plan for a 30-per-cent increase in lending activity, coupled with the expected rise in intensity and costs of monitoring as project risks increase, is already putting pressure on the institution's administrative budget. Canada encourages the Bank to ensure it has adequate resources for the increased risks it is undertaking and welcomes the President's intention to temporarily increase staff to support the crisis response activities. However, the Bank's resources are limited and must be employed where they can most effectively advance the institution's mandate.

Third, the Bank should continue to collaborate with other International Financial Institutions (IFIs) to adequately respond to the crisis.

Canada is pleased with the Bank's approach to IFI collaboration during the crisis and would like to see it continue to be just as focused post-crisis. Clearly, each institution has a specific role to play. The Bank has been very successful in building a deep local knowledge and strong relationships through its presence in the region and enjoys credibility with key stakeholders, governments and market players alike. As such, continued positive collaboration with the IMF is essential, especially where the IMF has a programme to implement. Wherever possible, EBRD should continue to leverage resources from other IFIs that have greater resources, such as IFC and EIB, to ensure that appropriate solutions to problems caused by the financial crisis are developed and implemented in the Bank's countries of operations, the financial sector in particular. Canada commits to fostering cooperation in its various dealings with the IFIs and other countries.

In closing, I would like to thank President Mirow and all EBRD staff for a year of considerable accomplishments. The Bank's ability to provide an adequate response to the current global economic crisis will help shape the future growth and prospects of its countries of operations.

In the upcoming year, there will be no shortage of challenges. However, Canada has every confidence the Bank will continue to achieve progress and bring about enduring prosperity in its countries of operations.

I look forward to meeting you all again in Zagreb in 2010.

Annex 5—Summary of *Transition Report 2009: Transition in Crisis?*

The *Transition Report* is an annual report of the EBRD that charts the progress of transition towards a market economy in the Bank's countries of operations. The 2009 report examines how transition and reforms in the region have fared given the global economic and financial crisis. It covers the period up to October 2009. The report explores the impact of the crisis on reform and aims to answer the question of whether transition itself is in crisis.

Structural and Macroeconomic Impact of the Crisis

The global economic and financial crisis left most transition economies largely unaffected until mid-2008, after which the crisis hit the region hard as commodity prices collapsed, exports contracted and capital inflows stopped. This led to sharp output declines later in the year and in the first quarter of 2009. Output in the region fell by 6.3 per cent, with countries such as Armenia, Estonia, Latvia, Lithuania and Ukraine expecting double-digit declines in 2009.

By the first quarter of 2009, the entire region was hit by the crisis. Kazakhstan, Russia and Ukraine were hit particularly hard, while the Baltic States were also hit hard in terms of declines in house prices, credit and industrial production. By the third quarter there were signs that the downturn was bottoming out. However, unemployment and the volume of non-performing loans are expected to rise for several quarters to come, complicating and slowing the recovery in many countries.

Although there have been dramatic declines in output, collapses of banking systems and currencies have been largely avoided for three reasons. First, although many countries had large macroeconomic imbalances, financial sectors were relatively sound. Second, except for a few countries, such as Latvia, Russia and Ukraine, reversals in net capital flows were mild compared to the experience of past crises. Lastly, there was a coordinated policy response involving national authorities, international organizations and regional banking groups.

Each year the EBRD tracks the reform developments of its countries of operations through a set of indicators. Using numerical scores, the Bank measures how well a country has fared in moving towards the standard of a well-functioning market economy. As shown in Table 4, in 2009 there were fewer upgrades than in previous years. One region where progress remains evident and several upgrades have occurred is the Western Balkans. All countries in this region are either a candidate or potential candidate for membership in the European Union, which can provide an important motivation for reform.

In recent years downgrades had become rare, with no downgrades in the past three years and only one since 2003. However, this year, there were four downgrades: for the banking reform and interest rate liberalization indicator in Kazakhstan and Latvia; for the large-scale privatization indicator in Montenegro; and for the trade and foreign exchange system indicator in Ukraine. The country with one of the lowest average transition scores is Belarus (only Turkmenistan scores worst), where the state continues to dominate decision making in many important sectors of the economy.

Table 4

Transition Indicator Scores, 2009

Country	Population mid-2009 (million)	Private sector share of GDP mid-2009 (EBRD estimate in per cent)	Enterprises		
			Large-scale privatization	Small-scale privatization	Governance and enterprise restructuring
Albania	3.2	75	4-↑	4	2+
Armenia	3.2	75	4-	4	2+
Azerbaijan	8.4	75	2	4-	2
Belarus	9.7	30	2-	2+	2-
Bosnia and Herzegovina	3.8	60	3	3	2
Bulgaria	7.6	75	4	4	3-
Croatia	4.4	70	3+	4+	3
Estonia	1.3	80	4	4+	4-
FYR Macedonia	2.0	70	3+	4	3-
Georgia	4.5	75	4	4	2+
Hungary	10	80	4	4+	4-
Kazakhstan	15.7	65↓	3	4	2
Kyrgyz Republic	5.1	75	4-	4	2
Latvia	2.3	70	4-	4+	3
Lithuania	3.4	75	4	4+	3
Moldova	3.4	65	3	4	2
Mongolia	2.8	75	3+	4	2
Montenegro	0.7	65	3↓	4-	2
Poland	38.0	75	3+	4+	4-
Romania	21.7	70	4-	4-	3-
Russia	142.2	65	3	4	2+
Serbia	9.9	60	3-	4-	2+
Slovak Republic	5.4	80	4	4+	4-
Slovenia	2.0	70	3	4+	3
Tajikistan	6.8	55	2+	4	2↑
Turkey		70	3+	4	3-
Turkmenistan	6.5	25	1	2+	1
Ukraine	46.6	60	3	4	2+↑
Uzbekistan	26.0	45	3-	3+	2-

Table 4
Transition Indicator Scores, 2009 *(cont'd)*

	Markets and trade			Financial institutions		Infrastructure
Country	Price liberalization	Trade and foreign exchange system	Competition policy	Banking reform and interest rate liberalization	Securities markets and non-bank financial institutions	Overall infrastructure reform
Albania	4+	4+	2	3	2-	2+
Armenia	4+	4+	2+	3-	2+	3-
Azerbaijan	4	4	2	2+	2-	2
Belarus	3↑	2+	2	2+↑	2	1
Bosnia and Herzegovina	4	4	2	3	2-	2+
Bulgaria	4+	4+	3	4-	3	3
Croatia	4	4+	3↑	4	3	3
Estonia	4+	4+	4-	4	4-	3+
FYR Macedonia	4+	4+	2+	3	3-↑	3-↑
Georgia	4+	4+	2	3 -	2-	3-↑
Hungary	4+	4+	3+	4	4	4-
Kazakhstan	4	4-	2	3-↓	3-	3-
Kyrgyz Republic	4+	4+	2	2+	2	2-
Latvia	4+	4+	3+↑	4-↓	3	3
Lithuania	4+	4+	3+	4-	3+	3
Moldova	4	4+	2+	3	2	2+
Mongolia	4+	4+	2+	3-	2+	2+
Montenegro	4	4	2↑	3	2-	2+↑
Poland	4+	4+	3+	4-	4-	3+
Romania	4+	4+	3-	3+	3	3+
Russia	4	3+	2+	3-	3	3-
Serbia	4	4↑	2	3	2	2+
Slovak Republic	4+	4+	3+	4-	3	3+↑
Slovenia	4	4+	3-	3+	3	3
Tajikistan	4-	3+	2-	2+	1	1
Turkey	4	4+	3-	3	3-	3-
Turkmenistan	3-	2	1	1	1	1
Ukraine	4	4↓	2+	3	3-	2+
Uzbekistan	3-	2	2-	2-	2	2-

Source: EBRD, *Transition Report* (2009).

Note: The transition indicators range from 1 to 4+, with 1 representing little or no change from a rigid centrally planned economy and 4+ representing the standards of an industrialized market economy. ↑ and ↓ arrows indicate change from the previous year. Up arrows indicate upgrades, while down arrows indicate downgrades. One arrow indicates a movement of one point (from 4 to 4+, for example), two arrows a movement of two points. 1 to 2- is treated as one upgrade. Population data for Serbia excludes Kosovo.

Development Based on Financial Integration and Commodity Revenues

The 2009 *Transition Report* examines the importance of managing the risks while reaping the benefits of financial integration.

Financial integration—in the form of large debt flows, foreign direct investment and an increasing presence of foreign banks—has been an integral part of the "development model" of transition countries (particularly in Europe) over the last decade. The region's slide into deep recession has raised questions about whether the growth benefits associated with this model may have been short-lived and whether the model created vulnerabilities that have been a contributing cause of the crisis.

Macroeconomic and sector-level analysis shows that financial integration did in fact boost long-term growth in the transition region. At the same time, there is evidence that the process of financial integration—particularly large inflows of foreign financing—has indeed contributed to credit booms and foreign currency lending. These, in turn, deepened the crisis and complicated its management.

The report argues that while financial integration cannot and should not be reversed, its risks must be better managed. This means addressing the bias toward foreign currency lending through macroeconomic policies, regulation, and the creation of legal frameworks and market infrastructures that support local currency finance. It also requires countercyclical financial sector policies that mitigate credit booms, regardless of whether they originate from capital inflows or domestic sources. To be effective, these policies need to be consistent across jurisdictions or formulated at a regional level.

The report also looks at how well commodity-rich countries have fared during the crisis, and the importance of diversification strategies and improving institutions in these economies to avoid the "resource trap."

Commodity-rich transition countries, such as Azerbaijan, Kazakhstan, Russia and Turkmenistan, have been on an exceptionally fast-growth trajectory since the late 1990s. In the long term, however, these countries tend to grow more slowly than their resource-poor peers because they have higher macroeconomic volatility and commodity "rents" undermine incentives to improve economic institutions.

To avoid this resource trap, resource-rich economies can attempt to diversify. In some respects—particularly in financial development and in building and managing stabilization funds—they have been fairly successful. Partly for this reason, the impact of the crisis on resource-rich transition countries does not appear to have been worse than elsewhere. However, raising the share of non-commodity tradeable sectors in GDP or exports has so far proved elusive, perhaps because success in diversification, as empirical analysis shows, depends on institutional quality. One approach suggested in the report is to deepen reforms in areas such as macroeconomic, financial sector and competition frameworks, where resource-rich transition countries have already demonstrated their ability to make progress.

Transition in Crisis? Impact of the Economic and Financial Crisis on Reform

The report concludes that while the 2008–2009 economic and financial crisis has led to a slowdown in reform, unlike the 1998 crisis in Russia, it has not triggered a major reversal. An analysis of government changes since early 2008 suggests that the political and reform orientation of governments has generally been preserved and favoured pro-reform parties. The lack of an anti-reform backlash reflects more mature economic institutions and political systems compared with 1998, better integration into regional and global institutions, and a more successful crisis response, which has prevented high inflation and banking system collapses.

Annex 6—CIDA Programming in EBRD Countries of Operations

In order to increase the effectiveness of its programming, CIDA is focusing its efforts on a limited number of countries in the region. Efforts are therefore concentrated in Ukraine, which is the main country of operation. CIDA also has active bilateral programming in the Balkans (Bosnia and Herzegovina, Serbia, and Montenegro), Tajikistan and Russia. The highlights of CIDA's programming in EBRD countries of operations can be found below.

Ukraine—Since 1991, Canada has provided C$395 million in technical assistance to Ukraine. The goal of CIDA's bilateral Ukraine Program is to improve economic opportunities for Ukrainians in a strengthened democracy. Current programming builds on past efforts and focuses on Ukraine's sustainable economic growth. This is being pursued through improvements to the business-enabling environment and by promoting entrepreneurship with a view to increasing the competitiveness of small and medium-sized enterprises, especially agricultural producers, in domestic and international markets. To accelerate economic development, CIDA will also be focusing on rule of law and improving accountability of public institutions.

Russia—To date, Canadian technical cooperation programming expenditures in Russia total C$360 million. CIDA programming in Russia has mostly focused on governance to support public administration reforms, rule of law and civil society.

Balkans—Since 1990, CIDA has disbursed over C$540 million in funding to the Balkans for approximately 800 projects. CIDA's Balkans Program has focused on countries that are key to regional stability: Bosnia and Herzegovina, and Serbia. The program has shifted from post-conflict technical assistance to institutional capacity building, and is directed at initiatives that contribute to public sector reform and enhance social capital in the areas of rule of law, health and education. Gender, youth, environment and refugees are cross-cutting issues which have been addressed by these investments.

South Caucasus—CIDA has been present in the South Caucasus region since 1992, lending its support to initiatives aimed at improving governance structures and institutional capacity, strengthening civil society, promoting peace and security, and enhancing respect for human rights and democracy. To date, CIDA has disbursed over C$60 million in assistance to the region. The majority of funding has been allocated through responsive programming, with remaining funds provided via humanitarian assistance grants and the Canada Fund for Local Initiatives. Georgia has received C$33 million, which represents the majority of CIDA's assistance in the region.

Tajikistan—Canada has had a presence in Tajikistan since 1994, working with its partners to reduce instability through poverty alleviation, particularly in rural areas. Tajikistan's openness to cooperation with aid partners also allows Canada to contribute to regional security in Central Asia. The Tajikistan Country Strategy focuses on governance and private sector development within the broader realm of agrarian reform. CIDA's assistance program for Tajikistan focuses on agrarian reform in rural areas, where the majority of the population lives. CIDA's approach is to foster local ownership and leadership. At present, Canadian support targets democratization and public sector capacity building in rural agrarian reform as well as the promotion of rural entrepreneurship and access to markets for rural producers.

Europe Regional Program (ERP)—The ERP works with select multilateral and bilateral institutional partners that are addressing issues of regional and transboundary interest. The ERP collaborates with the EBRD and the Organization for Security and Co-operation in Europe in the areas of governance, private sector development and environment, with gender equality as a cross-cutting theme. The ERP helps co-ordinate and facilitate program activities undertaken by geographic programs, and collaborates closely with other government departments to ensure policy coherence and a whole-of-government approach.